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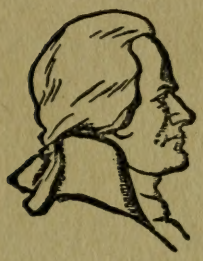
[Modern business Talks]

What Do You Know About Wall Street?

Do you understand why and how the market establishes values and prices?



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Talk No. 39
(With Volume 20)

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What Do You Know About Wall Street?

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This Talk, to be read in connection
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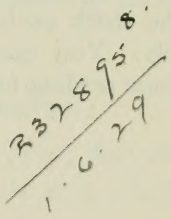
READING ASSIGNMENT 39



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READING ASSIGNMENT

The current Reading Assignment consists of three parts: (1) this Talk, (2) Chapters I to XII of Volume 20, "The Exchanges and Speculation," and (3) Lecture No. 20.

Into the exchanges pours from all sources information which brings demand and supply into equilibrium and determines the price of securities and commodities. Into the Modern Business Course has flowed the information out of which the body of business principles grows. Shrewd men avail themselves of the stock exchange, but to do so they follow it closely. You cannot get the full benefit of your business reading unless you follow a like course.

What Do You Know About Wall Street?

> There are (many), unhappily, who ignorantly and foolishly abuse these facilities (of the exchanges). These are people who approach the market in a gambling spirit, who know nothing of its purposes, and are incapable of understanding the mighty influences which dominate it.—Page 11, Chapter I, Volume 20, of the MODERN BUSINESS Text.

"What do you know about Wall Street?"

Put this question to the next half dozen people you meet and you will probably receive as many different answers. They will tell you what they think, not what they know. Too many otherwise well-informed persons have not only crude but distinctly misleading ideas about the security market.

An Unintentional Caricature

"Wall Street", says one. "Why, yes, that is where the money barons get their wealth and where they screw up the prices of everything the common people use. If it weren't for Wall Street with its pools and rings, its juggling and manipulation, the cost of living would not be so high as it is today and the workman would receive a just compensation for his labor. Wall Street is the real power in the land, and politicians

take their cues from the big financiers down there. We shall never have a real democracy in this country until the people do away with Wall Street and stop wholesale plundering of the people!"

It is not only the rabid socialist or the ignorant backwoodsman that draws this caricature. It comes, too, from sources that ought to know better. Not so many decades ago a prominent clergyman, whose weekly sermons were printed and read thruout the United States and in other English-speaking countries to which the cable carried them, inveighed with eloquent scorn against the wickedness of Wall Street. And he was not alone among his kind to protest against this "social cancer." Nevertheless, Wall Street has persisted in its work and has grown larger and stronger with the years.

The Tale of the Shorn Lamb

Equally bitter, tho even less convincing, is the answer of the man who has "been there" and who has come out minus his accumulated savings. He will tell you with emphasis and indignation that Wall Street is nothing more nor less than a den of thieves. "No honest man", he will say, "has any business in Wall Street. I made the mistake of believing that the sleek and well-fed Wall Street brokers were as honest as myself. I trusted them with my money, and now—"

The testimony is neither competent nor unbiased, and perhaps it would have been different had the speaker "made a killing." His words sound like the bleat of the "lamb" that wandered into unfamiliar

paths and was "shorn" for its pains by those who always lie in wait for just such visitors.

The Investor

"Wall Street?" says the cautious investor. "The only safe place to buy bonds. I never speculate, but in investments I prefer one whose value can be ascertained without too great an effort. Some like mortgages, but I have always thought them a nuisance, for I have not had the time or the patience to find out what they are worth. Give me bonds. They are carefully investigated by experts before they are put on the market, and there is a constant, known demand for them which fixes their value. I keep away from stocks, unlisted securities and small issues and advise others to do the same."

It is plain that however well our informant knows his own business, he knows as little about Wall Street as a casual purchaser in a department store knows about running the store. He has no conception of the inside of the works.

The Man Who Knew

The question "Do you know anything about the stock market?" was put to a young man who recently had been placed in a position of trust and responsibility. He had charge of considerable expenditure and had to pass, in confidential judgment, on the credit and business standing of customers of the firm.

"The stock market? No, that is about the last thing

in the world in which I take an interest. I should be suspicious of any credit customer of ours if I knew that he speculated in the stock market."

"Nevertheless", said the questioner, an elderly merchant who had taken a kindly interest in the younger man, "it might do you no particular harm to know a little something about the stock market."

"Why, I don't intend to speculate!"

"Probably not", said his friend, "but there are other things to consider. At the present time industrial conditions are stable and the country's prosperity is in no particular danger, but the time is sure to come when important changes will take place and when certain industries will feel the pinch of the rising cost of raw materials and the decreasing demand for their products. Your customers are paying pretty regularly now, but can you be sure that in six months from now they will cause you no worry?

"You are, I presume, extending credit rather freely at present, but before long you will find it desirable to contract your lines. Conditions are developing which eventually will make the money market tighter, labor more difficult to obtain and business ventures more risky.

"These changes are foreshadowed by events in the stock market. To those who read the signs aright, coming events announce their approach. When the panic of 1907 arrived, it played havoc with business and forced many enterprises to the wall for lack of ready cash, but it found the United States Steel Corporation amply provided with ready funds, so that

not only was it able to ward off temporary embarrassment, but also to take a decidedly profitable advantage of the situation. That was because its financial managers had kept a finger upon the business pulse of the country thru watching the security market.

"Again, if you will note carefully, you will find that while the men who are at the heads of big business affairs generally have specialized in one or two departments of business, they have nearly all acquired that liberal education which comes from touching the business world at different points. They have a broad knowledge of finance, and what is especially important, they have the ability to link their individual affairs with the general business conditions of the day. They know how to read the signs that concern world industry and commerce, and it is in the stock market that these signs first appear. Whether these men are directors of corporations that issue stocks or bonds, or bankers who lend on stocks as collateral, or capitalists who are members of syndicates, they couldn't do much if they were ignorant of stocks and the stock market."

Getting at the Facts

The young man was impressed; it would be too much to say that he was convinced. Yet he had so much respect for the opinion of his adviser that he made up his mind to look into the matter. He began to give attention to the financial page of the newspaper and finding it rather hard to understand, he got

from the public library some books on the subject. As he read he began to see the light.

Meeting his friend some time later, he said, "I want to thank you for your advice about the stock market. I have succumbed to its lure. Oh no! you have not launched me on a wild career of speculation, but I am finding the subject a fascinating one and I think I can see, as you told me, how it will be valuable to me to keep myself posted."

"Tell me your first impressions", said the friend.

"There is a great deal to be said", replied the young man, "but what strikes me most is the way in which all business seems to center there. I have found that Wall Street prices are based upon judgments of facts, and that Wall Street is a sort of vast reservoir of information, into which pour in a hundred different ways facts which have an influence in fixing prices. Why, it almost seems to me as if the New York Stock Exchange, and those of London, Paris, Berlin and other places were the nerve centers for the business of their respective countries."

"Well, I think you are on the right track", said the merchant, "and that suggests a comparison. Have you ever visited a central telephone office and seen the hundreds and thousands of wires which come in and are connected as people desire to talk? Did you ever think how all the community's business, its joys, it griefs, its love affairs, pass thru such an office? Well, now that you have been studying the stock market you will realize why such an office is called an exchange."

Visiting the Street

Probably no better introduction to this immensely interesting subject could be found than that which the author provides in the early chapters of the current reading assignment. He takes us right into "Wall Street", acquaints us with "the market", shows us the Stock Exchange in operation, describes the various activities of brokers and tells us how securities are "listed" on the Exchange. Many things strike you in following the author in this brief excursion; first of all, perhaps, the high standard of honor maintained in all the functions of this giant institution. You very soon reach the conclusion that if there is any shady work being done in Wall Street, it certainly is not done on the Exchange. Not only is the integrity and responsibility of every member investigated most thoroly, but such heavy penalties are prescribed for evil-doers that even if any one were inclined to mischief, the infallible consequences would deter him.

High Business Standards

Henry Clews, one of the oldest members of the New York Stock Exchange, speaks of it in his "Fifty Years in Wall Street", as follows:

I can from my long experience testify to the integrity and high character of its membership and the strict discipline of that Association over those composing it. Any breach of its rules, any deviation from the line of fair dealing or anything prejudicial to its members is promptly investigated and as

promptly punished, when proved to the satisfaction of the Governing Committee, by fine, suspension or expulsion. But it is very rare for a member to be charged with or found guilty of chicanery of any kind.

As to the securities dealt in on the floor, no man ever scrutinized a borrower's collateral so thoroly as the Exchange authorities examine the stocks that are offered for listing. Certainly, no "wildcat" stock, however skilfully camouflaged, ever succeeded in concealing its true nature from the argus-eyed Stock Listing Committee, or in passing undetected before the inquisitive Governing Committee of the Exchange.

"Margins"

Of course, investment is based upon buying and selling, and success in the security market depends upon knowing *how* as well as *when* and *where* to buy and sell. But it does not follow that all who buy in that market "pay as they go." Many of them pay only a small part of the purchase price, and rely upon their brokers to supply the remainder of the cash required. This is "buying on margin."

It is this sort of dealing that so often brings disaster to the would-be financier who invades the Street with a modest capital in the hope of doubling or trebling it in short order, but who is without sufficient knowledge of speculation to operate intelligently. It is also, however, the method followed by the seasoned speculator who wants his capital to reach as far as possible. Speculation looks for its

reward to a change of price of the stocks bought or sold; investment to the income which securities will bring. Hence, of course, conservative investors do not buy on margin. Nor is this a game for the novice or the ignorant, tho in this respect it differs but little from any other business. The large annual list of commercial failures reported by Dun and Bradstreet bears witness to the fact that inexperience and ignorance are not limited to the unsuccessful operator in Wall Street.

Hopes that Went A-glimmering

Among the many who thru fault of their own have lost their savings in unsuccessful attempts to get rich quickly by the Wall Street route, but who nevertheless declaim bitterly against the "wolves" which they say infest that district, there is an Indiana merchant who sold his store for $75,000 and came to New York because he wanted to make his money work faster. He cared nothing for the gilded palaces of Broadway, nor had he any social hankerings. Moreover he would have scorned any questionable enterprise that thru cleverly worded advertising offered large returns to investors. He would not be misled. He had come at the call of Wall Street where he knew great financiers had made vast fortunes. He would, as he said, "play the game according to Hoyle."

From his point of view he moved cautiously. For two full months he merely observed, listened, followed the beaten paths open to the public and read everything he found that related to securities—and not a

quotations to the rumors of the movements behind them. During this time he made the acquaintance of men who seemed to be prosperous, who thought in large figures and who mentioned familiarly the names of the giants of finance.

Then he began to dabble in stocks—he called it operating, for the word "speculating" would probably have shocked him. At first he bought sparingly and with some success. The men who seemed to know so much of the Street became his friends—and his end was the usual end of such men in such adventures. In less than a year he was not *in* the Street, but *on* it. What is left of him looks upon Wall Street as a nest of gamblers. It never occurs to him that he was a gambler himself. He lacked the knowledge that comes from personal study and experience, and he relied instead upon the tips that interested parties were offering him so freely.

A Stabilizing Influence

It is well that every reader of the Modern Business Course should have a clear conception of Wall Street as it is. The fact is that business has created Wall Street and that business is using it to serve its own ends. One of the great and salutary influences of Wall Street is that which it exerts upon the money market by way of stabilizing it and thereby preventing panics. The rapid shifting of credit from one market to another is an effective means of relieving undue money pressure. A manufacturer who in ordinary

times may borrow at 5 per cent, and who bases his estimate of purchases and production upon that circumstance, would not be able to figure so accurately in the absence of Wall Street operations. For in that case the rate would be largely governed by local demand. One day the rate might be less than 5 per cent, but the next it might rise to 8, 10 or more. Wall Street, thru its large borrowings of call money absorbs the shock of local jolts and therefore helps to stabilize the rate and prevent a congestion or a depletion of funds.

Here the law of supply and demand is seen in operation equalizing the market. When money is plentiful, rates fall and brokers borrow heavily. As funds become depleted, rates rise and brokers pay their loans. As loans are paid, the supply increases and rates again come down, the tendency always being to equalize the market thru the interaction of demand and supply.

Accordingly, not a little hardship is experienced by business when the Stock Exchange is closed. Everyone remembers the closing that followed the outbreak of the War, and the sudden tightening of all lines of business. Everyone, too, remembers the relief that business men felt when it was announced that the Exchange was about to be reopened. The young man whose story has been told was keener than he knew when he said that Wall Street is the nerve-center of the business organization of the country.

Many, moreover, who regard Wall Street with indifference if not with scorn or contempt, contribute

indirectly to operations in securities. If they put their savings in a savings bank, they enter the stock market by proxy, since the bank usually invests a part of its funds in securities. Nor if they prefer to invest their money in insurance, do they keep it out of Wall Street. Little business and big business are inextricably bound up with one another, and big business finds the Stock Exchange indispensable.

How the Wheels Go Around

In the fourth chapter of our assignment, the author describes the manner in which the security broker finances his purchases when he buys for his clients, on margin, large holdings of stocks which must invariably be paid for in cash before they are surrendered. The next chapter shows how and under what conditions the banks cooperate with the brokers in financing the latters' operations. It proves, too, that a broker must be a man of integrity and good business standing.

Most of us are familiar with the term "bulls" and "bears." We may not, however, understand such purely technical terms as "puts", "calls" and "straddles." These and other matters relating to the methods of trading on the Exchange are important items in that business and are all interestingly explained in Chapters VI and VII of our assignment.

In this connection it should be plain to any one that the best safety device against unwise stock speculation—against the excesses so frequently following temporary gain—is a sound knowledge of the work-

ings of finance. The trouble with most investors or operators who lose in Wall Street lies in the fact that they go into the *game* rather than into the *business* of the Street. They first lose their heads, and their money quickly follows. Having made a few dollars by turning over the securities of great, strong corporations—securities safe enough for even a child to handle—they conclude that they are equally well fitted to handle the highly explosive stocks, even tho possessing no knowledge of their peculiarities. The result nearly always adds to the reproach heaped upon stock investments. Yet toying with financial combustibles is a feat that few can perform very long, simply because such stocks are seldom subject to ordinary laws of investment.

Concluding Chapters

Chapter IX gives a description of the New York Curb market—that picturesque and vociferous throng which holds forth daily in Broad Street near the Stock Exchange. To the uninitiated, the antics of these men seem grotesque and perhaps utterly irrational, but here again appearances deceive. There is system in all they do, just as they themselves are perfectly organized and membership in their organization is a coveted privilege. The nature of their work is important and its relation to the Stock Exchange is concisely described in that chapter.

The assignment closes with one chapter on other American Stock Exchanges (X) and two chapters

on the operation of similar institutions abroad (Chapters XI and XII).

Each of these chapters, as indeed the entire assignment, will be found to give an illuminative description of that highly important market, the security market.

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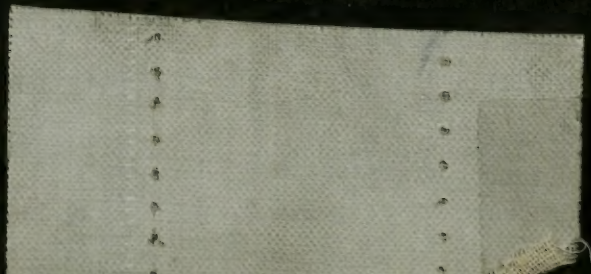

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